The MORTGAGE BANKER

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A BANKER OUTLINES WHAT HE THINKS A BANK'S MORTGAGE LOAN PROGRAM SHOULD BE

A Bank's Mortgages Are No Longer "Semi-Frozen" But "Semi-Liquid"

By WM. A. MARCUS

AS of June 30, 1938, the Controller of the Currency reports total deposits of about $59,000,000,000 lodged in slightly over 15,000 banks. Of these figures about 5,000 national banks accounted for roughly $27,000,000,000 in deposits and 10,000 state banks accounted for about $32,000,000,000 in deposits. Commercial deposits in all banks totaled $33,000,000,000 and savings about $26,000,000,000. The bulk of real estate loans, as to be expected, was shown to be in the state banks and savings banks which carried $7,000,000,000 of such loans against their savings deposits of $17,000,000,000. National banks as of that date carried $1,600,000,000 of real estate loans against their time deposits of $8,000,000,000.

Loans held by the banks of the country have shrunk materially during the past nine years. Whereas the aggregate deposits in our banks were only slightly higher in 1938 than in 1929, the total loans were cut in two from a 1929 total of $41,000,000,000 to a 1938 total of $21,000,000,000. The real estate loans during that period have dropped from $10,400,000,000 to $8,700,000,000.

The liquidation in real estate loans occurred in both the urban and farm classification. HOLC alone took over about $1,300,000,000 in residential loans from banks. However, that transfer of loans was of an emergency character. As soon as the distress was relieved, banks and other private lending agencies again provided the funds for financing homes.

The farm loan picture is somewhat different. The decline in farm loans has continued, the bulk of new farm loans now finding its way to permanent government agencies operating under the Farm Credit Administration, where for the most part the rates are much lower than currently charged by banks. Today, urban real estate loans account for 93 1/3 per cent and farm loans 6 2/3 per cent of the total real estate loans carried by banks.

MR. MARCUS, Vice President of the American Trust Company of San Francisco, was a speaker at our Chicago Convention in 1938 and recently addressed the Pacific Northwest Conference on Banking. In this article he is primarily concerned with what a bank's mortgage loan program should be. His analysis is of interest to all mortgage lenders because of the increasing importance of banks in the mortgage field. MBA's Bank and Trust Company Division, organized less than two years ago, now lists well over 50 members.

By reason of the need for liquidity, commercial banks have avoided real estate loans as investments for demand deposits. This policy has been sound, but because of traditional avoidance of what could be called long term or frozen credit, the strictly commercial banker has never understood mortgage lending and probably today fails to recognize many of the qualities of marketability and liquidity which have been injected into today's real estate loans. Let me say that commercial lending, encouraged by the Federal Government, as illustrated by industrial loans of five years or even longer maturity, has lessened its former requirements for liquidity, while mortgage lending to the contrary has insisted upon greater liquidity.

While I do not advocate the employment of demand deposits in mortgage loans, nevertheless I believe that a commercial bank may properly employ a portion of its time deposits in certain types of real estate loans. It seems to me that if a commercial bank accepts and pays interest on savings deposits, it must also assume the responsibility of investing those funds in accordance with the tested and proven experience of savings bankers who have long classed real estate loans as the backbone of their earning assets.

Thus eliminating purely commercial banks from further discussion and treating as one group the strictly savings banks and the savings departments of departmental banks, we can consider the problem "*What should be a bank's mortgage loan program?*"

When formulating this investment program, the thoughts in a banker's mind should be first, *safety of principal,* secondly, *ability to liquidate loans in order to pay deposits,* and thirdly, *rate of return.* Not every banker will agree

on the exact percentage of assets which should be held in cash, carried in bonds, and invested in loans. But most will agree that 40 per cent in cash and bonds is ample, and that 60 per cent of strictly savings deposits may be loaned with safety.

Banks Can Make Mortgage Loans With Safety

Can we make real estate loans with safety? My answer is "yes." Savings banks as a class have been doing so for many years. Of course, some mistakes have been made and losses suffered because of these errors as well as from the effects of serious economic depressions. The wise banker learns from such experiences and accordingly improves his lending procedure. Perhaps it is that we are not far enough removed from our last depression (or even not out of it yet) to forget these lessons, but at any rate the mortgage lending practices have greatly improved during the past ten years and such undesirable methods as were followed by some lenders in the pre-depression days should not return.

Let us examine some of the past errors affecting the safety of real estate investments and discuss the present improvement in method or reasoning. Answers to a recent questionnaire sent to a number of bankers throughout the country brought out these three principal reasons for foreclosures and losses in real estate loans:

1. Unamortized lending.
2. Improper appraisals.
3. Failure to give sufficient weight to earning power, and general financial standing and integrity of borrower.

I would change the order somewhat and place "Improper Appraisals" first, "Unamortized Lending" second, and "Standing of the Borrower" third.

The methods of appraising have improved greatly in recent years. Whereas formerly too much weight was given to actual cost or sale price and not sufficient weight to the normal earning capacity of the property, now appraisers of income property carefully check the market value or physical value against the capitalized income figure based upon fair rents which the property can be expected to produce from average tenants during normal times. Farm properties are no exception to the rule that they should yield the owner a fair return on the appraised value. The Federal Land Bank's qualification for security is a complete farm unit of sufficient size and earning power to meet all annual expenses, including principal and interest on the loan, insurance, taxes, wages, and other cash costs, in addition to providing a suitable living for the borrower and his family. The Federal Land Banks and other lending agencies of the Farm Credit Administration avoid the use of the word "capitalization" when estimating value based upon yield. However, they arrive at exactly the same conclusion by basing their appraisals on what they term "normal values". "Normal" appraised values are based on "normal earning power." "Normal earning power" is based upon the average production of crops suitable to be grown on that particular land at prices found to be "normal" or average over a certain period of years, after deducting all operating expenses and living costs, and after making adjustments for particular commodities, for character of the soil and numerous other factors.

THE Marcus "14 points" have to do with what he believes are the principal hazards banks should guard against in making mortgage loans. The author believes that mortgage troubles of the past have been primarily due to improper appraisals, unamortized lending and standing of the borrower — and he rates them in that order. He does not anticipate lower mortgage rates, but adds that "the effects of managed currency and government influence are hard to predict."

Good banking practice calls for an appraisal staff separate from the loaning officials. This permits the appraiser to make a detached analysis of the property without being influenced by the appeal of the applicant or by the desire to grant a loan because of substantial bank balances or similar reasons. The appraisal figure does, of course, set a top for the loan which can be granted, but the responsibility of exercising judgment on how much to lend within the appraisal limitation, the type of property to accept as collateral, the credit risk of the applicant, the terms of the obligation, and the interpretation of the general lending policy of the bank all rest with the designated loan officers.

If trained bank mortgage officials were asked to state the principal hazards to guard against when granting loans, I believe their composite advice would be:

1. Not to loan heavily on an over-improvement or an under-improvement.
2. Not to loan the legal limit on large expensive residences. (Incidentally, I believe the $16,000 limit set by the Federal Housing Administration on its insured loans on single family dwellings is an excellent one.)
3. Not to loan on properties in blighted areas.
4. Special purpose buildings, including theatres, lodges, club houses, etc., make bad loans.
5. Hospitals and other intitutional types of property are almost impossible to dispose of when they get into trouble.
6. Loans to churches should only be made after most careful consideration. Foreclosure in such cases creates an embarrasing situation and has a far reaching bad effect.
7. Hotels are usually unattractive security as their success is largely a matter of management.
8. Large industrial units of special design and single occupancy represent questionable security unless the buildings lend themselves to alteration suitable for other ordinary tenants.
9. Unimproved and unproductive land is not looked upon as good security, unless immediately convertible into productive use.
10. Subdivision loans are hazardous and should be confined to relatively small amounts even where building is assured in the near future, and then only when suitable paving, etc., has been installed and the property protected by adequate restriction as to the buildings and occupants.
11. Loans on service stations should not be made except to strong oil companies themselves, or where the owner will assign an irrevocable lease of a strong company and repay most of the loan during the period of that lease.
12. Extraordinary large loans to one borrower on any type of real estate security carry relatively a greater risk than the same total loaned in small amounts to many borrowers.
13. Don't lend on the hope or expectancy of future increased values.
14. Don't lend a borrower more than he ever hopes to or can repay.

Those "Stop, Look and Listen" items cover a lot of territory. I do not mean to infer that loans cannot be made on many of the types of property mentioned. If so, your field of urban loans would be narrowed down to small residences, flats, apartments, stores, and averaged sized industrial buildings. But experience shows that all special types of property contain an extra hazard and if you loan against them at all, your advances should be reduced in proportion to the extra risk.

Amortized Lending Pretty Well Established Now

The second contributing factor, namely, "unamortized lending" has been very well remedied. Today, mortgage lenders almost without exception insist on a monthly or seasonal reduction program. Instead of a one-year flat mortgage which was carried in most states for an additional four years without reduction, banks are now willing to write their loans for five or ten years, or even longer under Federal Housing terms, with an amortization running from 4 per cent to 10 per cent of principal per annum. The most popular form of installment note today calls for a fixed payment each month. Segregated, this payment of course shows a gradual decrease in the amount apportioned to interest and a similar increase in the amount applied to principal. Psychologically, this method is much better than the plan calling for a fixed monthly installment plus interest on declining balances. It is too easy for the borrower under that method to ask for a waiver of installments for a month or so and eventually expect you to carry the loan without any reduction. From the standpoint of both borrower and lender, we find a note calling for monthly payments, including interest, of 1 per cent of the original principal, to be a popular plan. Experience shows that the monthly amortized loans as a class are far safer and more satisfactory to borrower and lender as well, for the bank often could not collect on the principal on flat loans in case of need to pay depositors, and the borrower often could not produce the amount asked by the bank when the eventual day of renewal came around.

Look Into Integrity of Borrower Carefully

The third major cause of past trouble indicated by mortgage bankers was the failure to investigate the borrower's integrity and financial standing with particular references to his earning power. Even the utmost care exercised in this regard ten years ago would not have stopped losses if other factors of conservative lending were disregarded. Important as this reason is, there are many lenders who put too much weight on a borrower's standing when granting a loan, only to find out later that when the borrower is unable or unwilling to pay, it is practically impossible to get a deficiency judgment. Nevertheless, careful scrutiny of an applicant's reputation and earning capacity will enable the lender to avoid many mistakes. In this regard I believe the Federal Housing Administration has made a substantial contribution to sound lending policy in refusing to insure loans where the borrower's monthly outlay for principal and interest payments plus taxes and fire insurance exceed 20 per cent or 25 per cent of his net monthly income. Many banks today require a signed balance sheet from the applicant together with a report from a credit agency in every case before approving the application for a real estate loan.

The cumulative effect of amortized notes, of more intelligent appraising, of greater selectivity of property risks, and of credit investigation is reflected in the higher quality of today's real estate loans in the portfolios of banks observing such improved practices.

* * *

Many bankers would classify mortgage loans as "semi-frozen" assets whereas I choose to term today's real estate loans as "semi-liquid". I can best demonstrate this attribute by pointing out the experience of the bank with which I am connected. We had established a policy of amortized loans in 1926. By 1930 most of our loans were on a monthly reduction basis. The installments provided in our notes called for amounts which would pay off the principal sums in a little over ten years had they been written for that period. However, at that time we followed the general practice of writing our notes on a one year deed of trust basis, allowing them to run an additional four years before renewing. We found that even during depression years, in addition to the required installments, we were obtaining a voluntary payment of as much again. In other words, we were receiving as much in uncalled for partial payments and complete payments of loans as we had written into the terms of the notes themselves. Thus, instead of a turnover once in a little over ten years, we were actually getting a turnover once in a little over five years. This liquidity has continued up to the present time, although the factor of the longer maturities of Federal Housing loans has slightly lengthened the average period of complete turnover.

Three Extra Dollars to Work for Each Dollar Loan Rise

On January 1, 1938 we had $78,000,000 of real estate loans on our books. During 1938 we placed $22,500,000 of new loans on our books not including renewals and showed a net increase of but $7,500,000 at the close of the year. Fifteen million dollars, a little less than 20 per cent of our starting figure, was paid off during the year. It keeps us moving when we have to put three extra dollars to work for every dollar of net increase in our real estate loans!

Before the formation of the Reconstruction Finance Corporation in 1932 there was no established procedure whereby banks could borrow against their real estate loans or sell them in the open market. Such investments were not usable as collateral at the Federal Reserve Bank nor attractive to correspondent banks. Real estate loans had to rest on their own merits as to safety and the savings banker had to depend upon the orderly liquidation of such loans to meet with the demands of savings depositors. In addition to the Home Owners Loan Corporation and other emergency agencies, we now have a more or less permanent machinery to convert our solvent real estate loans into cash when necessary. One important contribution to that liquidity is Section 10 (b) of the Federal Reserve Act which now permits banks to borrow from the Federal Reserve Bank on many types of collateral including real estate loans. Another contributing factor is the Federal National Mortgage Association which offers to buy FHA loans and which can be expanded under government sponsorship to provide a tremendous fund for purchase of these loans, both in normal times and in time of distress. Irrespective of government agencies there has been created a good market for FHA loans. Banks, mortgage companies, insurance companies, and building and loan associations have been both buyers and sellers of these loans. This market will continue to grow because the uniform type of note, the same basic rules of appraisal throughout the nation, and the underlying guaranty of the United States Government all give buying institutions a confidence in FHA paper originating in sections of the country with which they are not intimately familiar.

Mortgages Have a Liquidity Unknown in Past

Thus both by reason of the terms of the notes themselves, and by their convertibility into cash through sale or pledge, our real estate loans of today have acquired qualities of liquidity not enjoyed by the real estate loans of a decade or more ago.

If you, as a savings banker, are satisfied with the *safety* and *liquidity* of qualified real estate loans, there only remains for your consideration the mat-

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ter of return. Because of the nature of real estate loans, mortgage rates have always averaged higher than rates for commercial loans and have not fluctuated widely from year to year. They are more apt to change gradually over a period of years than from season to season or from day to day. Just as the piling up of commercial deposits without a corresponding demand for loans has brought the commercial interest rate to a very low level, so the increase of savings funds, whether in banks, building and loan associations, or life insurance companies, has brought down the mortgage rates somewhat.

Lower Mortgage Rates Will Mean Less Savings Return

Because of indications of greater building activity and because the liquidation of real estate loans has largely ceased and new loans have turned the trend slightly upward, I believe that mortgage rates will not drop much further. Of course, the effects of managed currency and government influence are hard to predict and mortgage rates may be driven lower.

Present rates are comparatively low for the borrower, but fair to the lender under today's conditions. After all, if the level of mortgage rates should drop materially the banks would again adjust the situation by paying savings depositors that much less interest. In the eyes of most bankers this would be unfortunate as each reduction in savings interest is a further discouragement to thrift and does not contribute to healthy growth of the deposit end of our business.

* * *

As to FHA loans I do not wish to praise or condemn those features (i.e., 90 per cent lending policy and low rate of FHA foreclosure so far) which closely follow the terms extended under British housing plans. I am looking at the FHA loans only from the standpoint of the investment of bank funds. I should say, however, from the viewpoint of public welfare that the purchaser of a new house under FHA terms today is probably better off than many purchasers of houses of similar price under the conditions prevailing ten or more years ago. In the first place, the method of planning and construction has been improved under FHA's rigid but sound requirements. As a consequence the individual inexperienced buyer is less apt to buy a poorly constructed house if built under FHA inspection than if purchased from an operative (or speculative) builder without such inspection.

Then the creation of the insured single mortgage has largely eliminated the second mortgage in the financing of new homes thereby saving the owner considerable recurring trouble and expense. Let me cite an illustration: Under the old scheme of things the builder would obtain a flat mortgage of approximately one-half the selling price of the house. When he sold the property the new owner would pay him in cash, say from 10 per cent to 20 per cent of the purchase price, assuming the first mortgage and giving back to the builder a second mortgage representing the difference—often thirty to forty per cent of the purchase price. To illustrate—on a house selling at $6,000, the owner would pay in cash from $600 to $1,200, sign a second mortgage of between $1,800 and $2,400, sometimes flat but more often payable monthly in installments, and assume the first mortgage of $3,000. The builder would dispose of his second to individual investors or dealers in second mortgages for a cash price representing a discount of ten to twenty per cent of the face amount. Everything went well until the owner lost his job, or for some other reason had difficulty in making his monthly payments on his second. Frequently when trouble set in, the first mortgage loan came up for renewal. By that time the bank recognized the lessened value of the property due to wear and tear and obsolescence, and desired a principal reduction. If the owner could not satisfy the holder of the second and make a reduction on his first mortgage he stood a fair chance of losing his property to the second mortgagee.

Borrowers on New Property Safer Under FHA Plan

With the enactment of the National Housing Act and the creation of the insured single mortgage, the purchaser of a home with the same small down payment as under the previous method was provided with a plan easier for him to understand, free from the troubles and costs of renewals, and without the uncertain demands of the mortgagees. Furthermore, the monthly payment, including taxes and insurance, budgeted these housing costs in a fashion to overcome the failure on the part of many borrowers to build up a voluntary fund to meet tax payments and insurance premiums when due. And finally the refusal of the Federal Housing Administration to insure the loan unless the borrower could demonstrate an ability to comfortably meet his monthly payments made this new plan as foolproof as possible. It is therefore my belief that borrowers on new properties acquired under the FHA plan will be less likely to become delinquent in their payments to the bank than borrowers with the same small down payment under the system of first and second mortgages. Of course there are going to be delinquencies under either system and losses are possible under any plan unless the lender adopts a sound collection policy and gives careful supervision to all of his loans.

Suggests the Investment Possibilities of FHA Loans

The maximum rate of interest on FHA loans, as you know, is now 5 per cent with no service charge permitted. This rate in the West is probably below the average return on real estate loans, yet it is considerably above the return on government bonds. As you receive a government guaranty on your FHA loans you are justified in accepting a slightly smaller return than on other real estate loans. For that guaranty means that you receive in exchange for title to property foreclosed by you under FHA regulations either 3 per cent obligations of the insurance fund, taxable to the same extent as the original note would have been taxable, or 2¾ per cent debentures, non-taxable except as to surtaxes, inheritance or gift taxes. These debentures are dated to correspond with the day foreclosure proceedings were instituted by the mortgagee and, as you know, are guaranteed unconditionally by the United States. Because these debentures rank equally with other government obligations having the same tax exempt provisions, it seems logical that banks having large sums of savings or time money should seek to obtain the higher yield on FHA loans rather than to increase their long term government bond account. By that I do not mean to say that FHA loans in themselves are a substitute for government bonds. They are not. I merely point out the ultimate possible transition of FHA loans into government debentures and suggest that banks should review their investment programs to be sure that with the same underlying security they are getting the benefit of yield without sacrificing too much liquidity.

From your income on FHA loans you must, of course, deduct the cost of placing these loans on your books, keeping detailed bookkeeping records, and maintaining an experienced staff. Your net yield, however, should be considerably higher than your bond yield.

MORTGAGE FINANCING TODAY AND THE LENDERS WHO ARE DOING IT

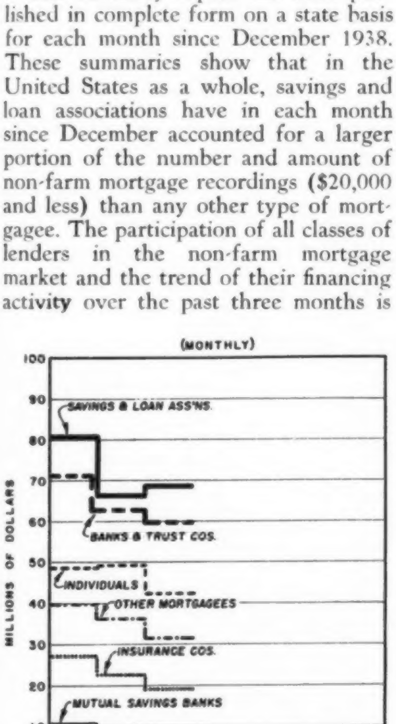
A Further Discussion of The First Nation-Wide Mortgage Study

By CORWIN A. FERGUS

For many years leaders in the field of home mortgage finance have posed the question, "Who is financing the home mortgage market?"

In an effort to answer this question, and also to provide some current information on mortgage activity on a national and local scale, the Division of Research and Statistics of the Federal Home Loan Bank Board has begun the compilation of a report of all mortgages of $20,000 or less, recorded on non-farm property and segregated on the basis of different classes of lenders. This study has been undertaken, and is being conducted with the cooperation of local savings and loan executives throughout the country, the United States Building and Loan League, the Mortgage Bankers Association of America, and the American Title Association.

The summary report has been published in complete form on a state basis for each month since December 1938. These summaries show that in the United States as a whole, savings and loan associations have in each month since December accounted for a larger portion of the number and amount of non-farm mortgage recordings ($20,000 and less) than any other type of mortgagee. The participation of all classes of lenders in the non-farm mortgage market and the trend of their financing activity over the past three months is indicated by the following step-chart showing the dollar amount of mortgages recorded monthly by each class of lender. *(See column one)*



***MBA is one of the three organizations cooperating in a nation-wide survey of the mortgage banking field. The brief account of this survey published in the April 1 issue has been expanded by Corwin A. Fergus, its supervisor, who is also Director of the Division of Research and Statistics of the Federal Home Loan Bank Board. He explains the purposes of the survey and forecasts the practical results mortgage men may expect from it. This contribution was especially prepared for* THE MORTGAGE BANKER.**

From the levels of mortgage activity established in December, each class of lender except one has shown a decrease in mortgage financing in the succeeding months. Despite the general decline exhibited by all lenders over this 3-month period, the downward movement should not be mistaken for a reversal in the progress of real estate financing since detailed studies of the mortgage activity of savings and loan associations over a 3-year period have established the existence of retarded business during this period of the year.

In February, the total number and amount of mortgages recorded of $20,000 or less, were distributed among the different mortgagees as follows:

Type of Mortgagee	Number	Amount
Savings and Loans	27,666	$ 68,840,000
Banks-Trust Companies	19,138	57,843,000
Individuals	22,903	42,528,000
Other Mortgagees	9,706	31,471,000
Life Companies	3,688	19,278,000
Mutual Savings Banks	2,059	7,031,000
TOTAL	85,160	$226,991,000

In terms of relative activity, the following "pie" chart shown in another column, gives the per cent of total recording business accounted for by each type of lender. Banks and trust companies accounted for one-fourth of the total, and individuals were responsible for almost one-fifth and savings and loans about a third. Insurance companies, mutual savings banks, and miscellaneous lenders contributed the remainder of the February business.

Savings and loan associations accounted for more mortgage financing than any other class of lender in 25 states. In Ohio, Indiana, Massachusetts, and Illinois the mortgage activity of these institutions was particularly large. Banks and trust companies surpassed other lenders in 12 states including California, New Jersey, New York, Michigan and Pennsylvania in which recordings were large in dollar volume. Insurance companies recorded the largest average-size mortgage in February at $5,200, and were followed in order by mutual savings banks at $3,400, other mortgagees at $3,200, banks and trust companies at $3,000, savings and loan associations at $2,500, and individuals at $1,900. Undoubtedly the low average-size mortgage recorded by individuals may be attributed to a certain extent to the recording of second mortgages by this class of lender.

Who's Doing the Lending in Two Typical States

As an indication of the significant differences in mortgage activity in various areas, California and Ohio are shown for February in order to give each mortgage operator an idea of valuable comparisons which can be made from the state table.

CALIFORNIA

Type	Amount	% of Total	Average Size
Banks-Trust Co.'s	$13,201,000	44%	$3,300
Savings and Loan	7,730,000	26	2,600
Individuals	6,931,000	23	1,800
Other Mortgagees	1,069,000	4	2,500
Insurance Co.'s	827,000	3	4,900
Mutual Savings	....	....	....
Total	$29,758,000	100%	$2,600

(Continued next page)

OHIO

Type	Amount	% of Total	Average Size
Banks-Trust Co.'s	$ 3,360,000	22%	$3,400
Savings and Loan	6,240,000	41	2,600
Individuals	1,668,000	11	1,900
Other Mortgagees	2,027,000	13	3,800
Insurance Co.'s ..	1,764,000	11	5,700
Mutual Savings......	237,000	2	3,800
Total	$15,296,000	100%	$3,000

As a further indication of the extent of mortgage activity in each state, to provide a means of comparing this activity, and to enable one to follow the trend of financing, the per capita rate of mortgage recordings has been computed. This rate, resulting from the adjustment of the dollar volume of recordings by the non-farm population in the area, showed that from $2.64 in January the rate declined to $2.46 in February. In February the highest rate of activity prevailed in the District of Columbia at $7.06 per person, while California was second at $5.88.

Mortgage Men Heretofore Unable to Gauge Markets

Never before have those engaged in the business of making loans on non-farm properties been able to gauge accurately the extent of their participation in the total mortgage market as compared with that of other classes of lenders. These summary reports will be available on a state basis every month, and will make such salient facts available regularly for current analysis and interpretation, so that every lender should find valuable use for the information in the determination of mortgage operations.

The recording of mortgages is necessarily a local function, for every mortgage to be most effective and to assure priority of lien must be registered by the county clerk or similar local official in charge of maintaining the records of land ownership. The records which accumulate in these local offices are a guide to general real estate conditions and provide an index of mortgage financing activity. Despite the usefulness of the mortgage recording material it is only recently that there has been any country-wide arrangement for gathering together these statistics and making them available in detail to the general public. It is true that there have been regional and local studies made in some parts of the country, but these have always been in terms of total recordings, with no indication of the participation by the various types of lenders.

In some of the larger metropolitan areas such as Wayne County (Detroit), Cuyahoga County (Cleveland), Marion County (Indianapolis), Cook County (Chicago), and Los Angeles County, individual studies in sufficient detail had been started by mortgage companies, title and abstract firms, and others interested in home mortgage statistics. In July of last year the mortgage recording data available at that time were gathered and presented as a summary for the first quarter of 1938. This summary included only eight large cities and the State of Massachusetts — a combined population of about 16,000,000. Many important areas were not represented at all, and no reports were included from communities having less than 350,000 population.

From this small sample it was clearly evident that a wealth of information would be available if the data could be collected in a uniform manner throughout the whole country. Keeping in mind the possible benefits of such a survey, the initial steps to organize a cooperative program for monthly reports of non-farm mortgage recordings were begun last summer thru the voluntary response of several associations to an appeal made for such statistics in the July issue of the *Federal Home Loan Bank Review*.

Encouraged by the results of this cooperative program, and motivated by the realization that a national and state trend analysis of great value to all lenders could be developed if data were secured from a sufficient number of communities, the Federal Home Loan Bank Board, during the latter months of 1938, undertook a definite program to extend the area covered by this initial study of mortgage recordings by type of mortgagee. Through the cooperation of local savings and loan executives throughout the country, the United States Building and Loan League, the Mortgage Bankers Association of America and the American Title Association, the report has grown until in February it included 408 counties, which contained 43 per cent of the total non-farm population of the country, and were located in 46 states. Early returns of the information for March indicate that the survey for that month will be even more inclusive.

The question which naturally arises in the mind of every mortgage lender is, "What can I learn from this new statistical service of mortgage recordings that will be helpful in conducting my institution's lending program?"

First of all it must be remembered that the structure of home finance is built upon a foundation of the conditions and trends prevailing in the local residential market, and that a thorough knowledge of the mortgage activity in a community is one of the prime requisites. However, to gauge one's position in the entire financial picture accurately, one must be able to correlate his knowledge of local conditions with the situation in his own state and in the neighboring or comparable areas. This will now be possible monthly through the state and national estimates of mortgage recordings which will now be prepared and published monthly.

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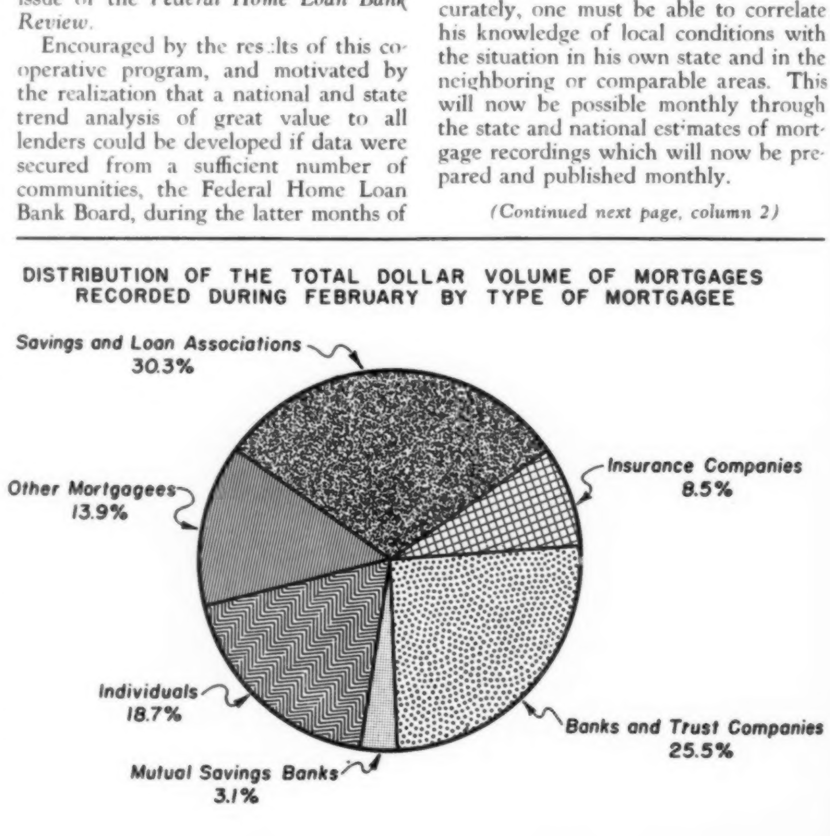
DISTRIBUTION OF THE TOTAL DOLLAR VOLUME OF MORTGAGES RECORDED DURING FEBRUARY BY TYPE OF MORTGAGEE



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MAY 15, 1939

BLOCK-WIDE HIGHWAYS

War scares abroad and declining business in this country have combined to focus relatively little attention on the President's new highway plan. Yet anyone interested in mortgage values and city planning could not fail to be impressed by the vastness of the scheme and what it would do for many of our large metropolitan centers.

Briefly the plan calls for the construction of a series of great block-wide highways over the country under a new government agency, the United States Land Authority. The purpose is two-fold: to relieve metropolitan traffic congestion and indirectly stop the spread of blight. The cost, it goes without saying, would run into billions. For example, the creator of the plan, Thomas H. McDonald, chief of the United States Bureau of Public Roads, said the cost in Baltimore would be $500,000 a mile.

No doubt some such plan like Mr. McDonald's is surely coming, but it may be some time away. But mortgage men who are thinking in terms of only a highway had best look further. The plan, as outlined, is much broader. The Authority will purchase land adjacent to these highways. If it is slum area, it will be cleared. Group homes, factories and other projects will be built. Land immediately adjacent to the highway might be used for building theatres, gas stations, garages and apartment houses owned and operated by the Authority.

There is little possibility of congressional action this year, but, say the sponsors, "probably next winter."

FERGUS OUTLINE OF MORTGAGE SURVEY

(*Continued from page 6*)

From a state table of mortgage recordings it will be possible for any lender to compute the average size of mortgage made by all types of mortgagees operating within his state. Such a ratio may be used in testing the safety of the mortgage portfolio as well as a guide to future lending. From these figures it is clear that there are variations in the size of mortgages written in different states by the same type of lending institution. There was an $1,800 difference during February in the average-size mortgage made by insurance companies in the New York-New Jersey area ($6,600) and those made in the southeastern states, where the average size mortgage recorded was approximately $4,800.

The extent to which various lenders are participating in home-financing activity in a given region is another important analysis which may be made from these figures. This can best be done by dividing the number and dollar amount of mortgages recorded by each class of mortgagee by the total mortgage activity for all lenders in that area. The percentages will vary in accordance with the difference in the average size of the mortgages made. In Illinois, during February, savings and loans accounted for 38 per cent of the total number of mortgages registered, but due to a smaller average-size loan ($2,800) these institutions accounted for only 29 per cent of the dollar volume.

This leads to another possibility of analysis: that of comparing a mortgagee's percentage of participation in different parts of the country. By studying these reports over a period of several months it will be possible to discover whether there is a trend toward or away from a particular type of lender as a source of mortgage money. For example, it would be quite interesting and significant if insurance companies during the next six months should double the proportion of their business in a particular state. Without the benefits of such a study the officials would be unable to determine whether their activity followed the general trend or was a significant business gain in actual as well as relative terms.

Similar studies and comparisons can be made from these summaries by any class of lender in any state. The full significance of the information will increase constantly with the accumulation of reports. In another year, month-to-month and year-to-year comparisons will be obtainable. At that time lenders will also be able to determine the trend of their business and that of others in the field, and the shifts taking place in particular areas.

To this end it is essential that more areas be covered by the submission of information by other cooperators. An increase in respondents will mean greater reliability of the compiled data.

MBA GOVERNOR

FREDERICK P. CHAMP

Frederick P. Champ was elected to the MBA Board of Governors in 1935. He has been president of the Utah Mortgage Loan Corp., Logan, Utah, since 1934 and vice president since 1920. The firm operates principally in farm mortgages in over twenty Utah and Idaho counties.

He was born in Salt Lake City and went to school there, in Colorado Springs and at Harvard. He was chief of the Office Service Division of the U. S. Food Administration during the War and later with the Near East Relief in New York. Still later he was a member of the Relief Commission in the Near East, Russia and Armenia.

He is a member of the Agricultural Commission of ABA and president of the Board of Trustees of the Utah State Agricultural College. He is a director of the Salt Lake City Branch of the San Francisco Federal Reserve Bank and a member of the district board of the RFC. He presided at MBA's Farm Mortgage Conference in Chicago last year.

"THE ACTUAL VALUE OF ANY PROPERTY IS WHAT SOME BUYER WILL PAY FOR IT"

And The Other Yardsticks Too Often Mean Trouble For The Appraiser

By STUART C. FRAZIER

MR. Frazier here concludes a discussion he began in the last issue on "Pitfalls Mortgage Lenders Should Avoid in the Valuation of Real Property". He warns against appraisals made "at more than cost" and points out that another real danger lies in over-emphasis of the potentialities of a district where the trend is definitely upward. Mr. Frazier is vice president of the Washington Mutual Savings Bank of Seattle, an MBA member.

III.

"*Appraising at more than cost.*"

Students of appraisal methods have a lot to say about "true value" but it all boils down to about this: that the actual or true value of a given property is what an informed buyer in funds will pay for a property under ordinary conditions and being sold by an equally informed owner. This eliminates consideration of "bargain" buying at distress sales or "inflation" buying by so-called smart money.

It is too common a practice in days of competitive lending conditions to appraise properties at more than their cost. Buyers of real estate are credited with some keen mysterious vision or technique which enables them to ferret out these tremendous "bargains" at less than their actual value. The best example I can give you on this involves a large, substantial and centrally located property that was in 1926, and still is, in a district of highly stable retail rents. The property was owned by an estate which was financially strong. The property had been leased in its entirety, with ten years yet to run, to an operator at a figure of $50,000 net to the owner annually. On the basis of rentals in 1926 the operating lessee was making over $20,000 net annually above the rental he paid, indicating an annual earning capacity for the property of $70,000 net before depreciation. The property was sold by the estate in 1926 to a syndicate at $810,000 cash. Within 90 days there were five appraisals made of this property, none of which was less than $1,100,000 and the agreed appraisal for loan purposes was set at $1,140,000, or 40 per cent more than the purchase price. This figure of $1,140,000, it was stated, was easily justified by capitalizing the actual net earnings of the building at 6 per cent and concluding that the sale of $810,000 was by virtue of the new owners not receiving the full income of the building, but only the lease rental of $50,000. I wouldn't quarrel particularly with the capitalization rate of 6 per cent except to state my belief that it should have been used only after deduction for depreciation. Anyway, a loan was made based on the $1,140,000 appraisal. Within a relatively short period, the largest paying tenant in the building began getting restless at the high rental being paid and eventually moved. Soon another large tenant announced he could not longer pay the extremely high rental he had been paying. (This was all before the depression.) The operating lessee had been "bleeding" his tenants to the core. *He* had nothing much to lose. Soon the property, though excellently situated, was getting a black eye among retailers and the lessee was pressing and squirming for sufficient earnings to pay his rental.

I contend that the former owners foresaw this development; and in the realization that they were precluded under their lease from interfering in the management of the property, sold it before even the net rental of $50,000 they were receiving became impaired, as it soon did. Why didn't those five appraisers, instead of succumbing to the allure of the perfume and accrediting the new owners with having negotiated a "steal" pull their hair in attempts to uncover what the perfume was trying to and *did* obscure?

The fact that the property sold for $810,000 should have been evidence enough under all the known circumstances that that figure represented its value. Had a mortgage loan—based on that value—been made in 1926, even though negligibly amortized, no difficulty to the owners or mortgagee would ever have been encountered to this date. *Beware of this type of appraisal.* There's a "nigger in the woodpile" someplace. And may I suggest that preinforming the appraisers of the amount of loan desired no doubt played a large part in their reasoning as they built up an $810,000 property to one worth $1,140,000 all within 90 days.

Another danger pertains *to over-emphasis of potentialities of a district in which the trend is definitely upward.*

It's very tempting for owners and lenders alike to become over-optimistic about values in an improving district. The conservative investor or mortgage lender can't do business in these new districts based on his ideas of value and eventually either yields to the movement, or gets no business.

There is no doubt that the latter, in a majority of the cases, is money ahead of the one who yields to the pressure of valuating such properties upon a basis of speculative though actual sales.

In 1923 a certain downtown property "in the trend," so to speak, and well located to take advantage of future growth in this direction, (which seemed a foregone conclusion), was appraised at $150,000.

Two years later it was sold for $195,000, having a net income of $14,000. At that time it was appraised at $200,000, earnings being capitalized at 7 per cent, which was in line.

In 1928, three years later, this same property was appraised at $300,000 with net earnings of $15,000. The appraiser, in referring to three contiguous properties, cites their recent cost prices and based on his line of reasoning the subject property was worth as much—even though he had to use a 5 per cent capitalization rate this time. Let me quote from the 1928 appraisal: "The ground floor rental would ordinarily justify a valuation of $2,000 per front foot or $120,000. However, I value the land in line with going values in the neighborhood rather than on an income basis and put it at $4,000 per foot, or $240,000." In other words, "hocus pocus—it's worth twice as much as it's really worth." The property, still well located and still "in the trend" sold last year for $125,000. There are countless similar examples in every large city.

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